## JURISDICTION

The date of the judgment sought to be reviewed, and the time of its entry, is March 12, 1959.

The statutory provision believed to confer on this court jurisdiction to review the judgment in question by writ of certiorari is Title 28, Section 1254(1), United States Code (62 Stat. 928).

## QUESTIONS PRESENTED

(1) Whether petitioner, a single corporate taxpayer that has never been a party to a merger or other form of corporate reorganization, which withdrew from an unprofitable business and entered a new business out of which it sought to recoup its earlier losses, will be denied a deduction of a portion of its earlier losses from income earned in a fiscal year because of the decision of this Court in *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382 (1957), which held that a corporation surviving a merger may not carryover and deduct premerger net operating losses of one type of business against the post-merger income from another type of business, both of which businesses were operated and taxed separately prior to the merger?

(2) Alternatively, whether *Libson Shops, Inc.* v. *Koehler, supra,* which was decided under Section 122 of the Internal Revenue Code of 1939, governs the construction of Section 172 of the Internal Revenue Code of 1954, which this case involves?

(3) Whether petitioner, whose stock was acquired by new owners, may be denied, under Section 269 (a)(1) of the 1954 Code the right to deduct its own net operating loss carryover, when neither the petitioner nor the new owners of petitioner's stock acquired any deductions which it or they would not have

had irrespective of the purchase of petitioner's stock by the new owners?

## STATUTES INVOLVED

The statutes involved in this case are contained in the Appendix. They are Sections 172 (68 A. Stat. 63) and 269(a) (68 A. Stat. 80) of the Internal Revenue Code of 1954 [Title 26, U. S. C., Sections 172 and 269(a)] and Section 122 (53 Stat. 867, amended, 67 Stat. 807, 844, 847, 848; amended, 64 Stat. 918, 937; amended, 64 Stat. 1220; amended, 65 Stat. 500, 505, 517; amended, 67 Stat. 619) of the Internal Revenue Code of 1939 [Title 26 (I.R.C. 1939), Section 122].

## STATEMENT OF THE CASE

The facts we believe relevant to the questions presented above are these: Petitioner, a corporation, was organized in 1947. It reports its income for federal tax purposes on a fiscal year ending August 31. From its organization until September, 1952, petitioner was engaged in mining and selling coal and in leasing its coal mining properties (R. 15-16). The business was unsuccessful, and during its fiscal years ended in 1949 through 1953, petitioner incurred substantial net operating losses (R. 15). Finally, on September 1, 1952, petitioner sold its physical assets for a $71,648.61 note, secured by a mortgage, on which it made collections until December 31, 1953 (R. 16). On that latter date, the note and mortgage were transferred by petitioner to one of its stockholders in satisfaction of certain debts (R. 16, 35). On the same day, the stockholders sold the stock of the petitioner (R. 17). Under its new ownership, petitioner began transporting and selling bunker fuel oil. The business was relatively successful and petitioner began to recoup the losses that it had

incurred in earlier years while it was in the coal business (R. 104, 63, 64-5).

On its federal income tax return for the fiscal year ended August 31, 1955, petitioner carried forward and deducted from its income an appropriate amount of the net operating losses incurred by it during its fiscal years ended 1951 through 1954. The respondent disallowed the deduction, and asserted that petitioner owed a deficiency, relying on Section 129(a) of the Internal Revenue Code of 1939 (R. 10). Petitioner paid the deficiency and filed claim for refund. The respondent denied the claim and petitioner brought suit for refund in the District Court, jurisdiction being conferred thereon by Title 28, Section 1390, U. S. Code.

The District Court found that the principal purpose of the new stockholders in purchasing the stock of the petitioner was the avoidance of taxes. The District Court further found that at the time of the purchase, the law appeared to be well settled that the petitioner could not be deprived of its use of the carryforward under the circumstances of this case, and that the new stockholders were exercising honest business judgment in purchasing the stock (R. 92). The District Court held that the respondent had erroneously disallowed the net operating loss deduction under Section 129(a) of the 1939 Code because petitioner, immediately prior to the purchase of the stock, had the net operating loss carryforward and thus the purchase of its stock did not result in securing to petitioner any deduction the right to which it did not already have. The District Court further held that the new stockholders of petitioner did not acquire any deductions by reason of their purchase of the stock because they, being taxpayers separate from the petitioner, are not

entitled to use petitioner's net operating loss carry-forward (R. 92), and therefore Section 129(a) of the 1939 Code did not apply.

The District Court, however, directed a verdict for the respondent on the ground that petitioner was not entitled to the deduction by reason of the decision of this Court in *Libson Shops* v. *Koehler, supra*. On appeal (R. 116-123), the Court of Appeals affirmed the judgment but reversed the District Court in part, holding that petitioner was denied the deduction not only by reason of the decision of this Court in *Libson Shops* v. *Koehler, supra*, but also by reason of Section 129(a) of the 1939 Code.

## REASONS FOR GRANTING THE WRIT

**(1) The Court of Appeals has decided an important federal question in conflict with Libson Shops, Inc. v. Koehler, supra, in that the Court of Appeals has ruled that the rationale of Libson Shops applies to a single corporate taxpayer that changes its business, whereas this Court specifically stated that it was not passing upon such situations.**

The Court below held that the taxpayer, a single continuing corporation which has never been a party to a merger or any other form of reorganization, became a new "taxpayer", for purposes of Section 122 of the 1939 Code, when it got out of the coal business and entered the bunker fuel oil business. The Court below so ruled in spite of the fact that this Court stated that *Libson Shops* does not deal with single continuing corporations, *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, 390 (1957), footnote 9, and in spite of the fact that all of the decisions on this issue hold that a change of business by a continuing corporation does not result in a "new" taxpayer. *Northway Securities Company*, 23 B.T.A. 532 (1921), Acq. X-2 C.B. 52 (1931); *Alprosa Watch Corp.*, 11 T.C. 240 (1948);

*A. B. & Container Corp.*, 14 T.C. 842 (1950); *W A G E, Inc.*, 19 T.C. 249 (1952); *Great American Industries, Inc.*, 25 T.C. 1160 (1956).

**(2) The Court of Appeals has rendered a decision on two important questions of federal law that squarely conflicts with the decisions of the Tax Court of the United States.**

On facts indistinguishable from those here, and faced with contentions by the government identical with those made to the Court below, the Tax Court of the United States in *British Motor Car Distributors, Inc.*, 31 T.C. No. 44(1958) (reviewed by the entire Court, five judges dissenting), held for the taxpayer, ruling that *Libson Shops* v. *Koehler, supra,* does not apply to single continuing corporations, and that Section 129(a) of the 1939 Code [now Section 269(a) of the 1954 Code] is not applicable to instances of this nature in which neither the corporation nor the new stockholders obtain any deduction that it or they would not have had irrespective of the stock purchases. The Tax Court specifically held that the benefit interdicted by Section 129(a) of the 1939 Code was the direct use of the deduction by the acquiring person and any indirect benefit to a stockholder of a corporation with a loss carryover was not within Section 129(a)(1). The decision of the Tax Court with respect to its second ruling is consistent with all of its earlier decisions on the construction of Section 129(a) of the 1939 Code. *Alprosa Watch Corp., supra; Commodores Point Terminal Corp.*, 11 T.C. 240 (1948), Acq. 1949-1 C.B. 1; *W A G E, Inc., supra; T. V. D. Co.*, 27 T.C. 879 (1957).

On March 11, 1959, the Government indicated that it would petition to the Court of Appeals for the Ninth Circuit for a review of the decision of the Tax Court in *British Motor Car Distributors, Inc., supra.* (See

1959 P-H Para. 56,366.) In the event that decision is affirmed, a conflict will result between the Courts of Appeal for the Fifth and the Ninth Circuits. Even if reversed, however, there will still exist a conflict between those two Courts of Appeal and the Tax Court [see *Arthur L. Lawrence*, 27 T.C. 713 (1957)], until that conflict is resolved by this Court.

**(3) The Court of Appeals applied the provisions of the 1939 Code to this case, which involves a taxable year ended August 31, 1955, as to which the provisions of the 1954 Code, not those of the 1939 Code, are applicable. The failure of the Court below to apply the correct law to this case is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.**

This case involves a claim for refund based on a deficiency paid with respect to the taxable year that began September 1, 1954 and ended August 31, 1955. During that taxable year, the relevant sections of the 1954 Code (unless otherwise expressly stated), not those of the 1939 Code, were in force. Section 7851 (a)(1)(A), 1954 Code.

The Court below seems to have held, however, that the provision of the 1939 Code governed this case: "the taxpayer here, as in the *Libson* case, *supra*, is not 'the taxpayer' within the meaning of 26 U.S.C.A., Sec. 122(b)(2)(C),". (App. 11a). The fact is, however, that Section 172 of the 1954 Code, not Section 122 of the 1939 Code, is applicable to this case, and the words "the taxpayer" that appear in Section 122 of the 1939 Code do not appear in the relevant portions of Section 172 of the 1954 Code.

**(4) The Court of Appeals has decided erroneously that Libson Shops, Inc. v. Koehler, supra, is applicable under the 1954 Code. This federal question, of utmost importance to tax practitioners should be decided by this Court.**

The Court of Appeals applied its interpretation of *Libson Shops, Inc.* v. *Koehler, supra,* to a year governed by the 1954 Code. The Treasury Department has expressly stated that *Libson Shops* is not applicable to the 1954 Code. See *Technical Information Release,* No. 89, issued August 25, 1958. See also Sinrich, "Libson Shops—An Argument Against Its Application Under the 1954 Code", 13 *Tax L. Rev.* 167 (Jan., 1958). It appears that if *Libson Shops* applies to a single corporate taxpayer and is applicable under the 1954 Code, the provisions of Section 382(a) have been substantially narrowed by judicial fiat. That Section—new to the law and not applicable to this case (because of its effective date)—provides that a single corporation loses the benefit of its loss carryforward only if *both* its business is changed *and* there is a substantial change in the ownership of its stock. Yet under the decision below, a single corporation would lose its carryforward upon a change of business only. It appears also that, under Sections 381 and 382(b) of the 1954 Code, a corporation surviving a merger may use its own carryforward and those of the constituent corporations, regardless of a change of business, provided only certain stock ownership tests are met. Thus, the decision of the Court below renders it impossible for taxpayers and their advisers to rely, with safety, on what appears to be the plain language of the 1954 Code.

## ARGUMENT

### Section 172 of the 1954 Code

This case involves, in the first instance, the proper construction of the net operating loss provisions of the 1954 Code. The principal question raised in this respect—whether a corporation may carry forward and deduct net operating losses incurred by it in prior years in one type of business from subsequent income produced by it in another type of business—is of importance to all of the many corporate taxpayers that have changed or plan to change business activities. The question would appear to be of crucial importance to the many relatively small corporations, whose operations are not frozen to heavy plant investment and whose lines of business may therefore be subject to change as new business opportunities are presented. As indicated by a recent government survey, the active small corporations (with assets of less than $25,000) filing Federal income tax returns showed a total overall deficit of $124,860,000 during the twelve months ended June 30, 1956, of which all or a substantial portion is available as a net operating loss carryforward. In addition, during that year, these corporations claimed total net operating loss carryforward deductions of $41,919,000. Furthermore, the active corporations with assets between $25,000 and $50,000 claimed

total net operating loss deductions during that period of almost 50% of their total net profits.[1]

It is primarily these corporations—for whose benefit so much legislation has been recently enacted—that will bear the brunt of the ruling of the Court below. We submit therefore that the decision of the Court below deals with matters of public importance that should be considered by this Court.

The decision of the Court below is based on its holding that *Libson Shops, Inc.* v. *Koehler, supra,* applies to single corporations. That holding is not only unwarranted by the very language of the opinion in *Libson Shops*, but is also in irreconcilable conflict with the decision of the Tax Court of the United States. See

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[1] During the year ended June 30, 1956 (the most recent period for which statistical data is available), all active corporations filing federal income tax returns claimed as deductions a total of $836,133,000 in net operating loss carryforwards. The data below, for the year ended June 30, 1956, shows the relative importance of the loss carryover deduction to small corporations:

| | Number | Total Assets | Net Profit | Net Operating Loss Deduction Claimed |
|---|---|---|---|---|
| | | (1,000's) | (1,000's) | (1,000's |
| All active corporations * | 746,962 | $87,374,680 | $47,601,137 | $814,86 |
| Corporation, by size of assets | | | | |
| 0-$25,000 | 185,260 | 347,873 | (124,860) † | 41,91 |
| $25,000-$ 50,000 | 114,304 | 530,476 | 88,034 | 41,03 |
| $50,000-$100,000 | 131,510 | 1,088,667 | 352,669 | 74,56 |

* As to which balance sheets were filed with the tax returns.

† Net loss or deficit.

Data compiled from: U. S. Treasury Department, Internal Revenue Service, Publication No. 16(6-58), "Statistics of Income—1955, Corporation Income Tax Returns for Tax Years Ended July 1955-June 1956."

*British Motor Car Distributors, Inc., supra,* where the Tax Court said:

> "With reference to the applicability of *Libson Shops, Inc.* v. *Koehler,* supra, we do not understand the opinion of the Supreme Court in that case to cut as deeply as the Commissioner contends. There, 16 sales corporations were merged into petitioner and the effect 'was to convert 16 retail businesses and one managing agency, reporting their incomes separately, into a single enterprise filing one income tax return'. The Supreme Court held that the petitioner could not make use by way of carry-over of the previously sustained net operating losses of some of the merged corporations. This conclusion was apparently based upon a holding that petitioner was not the same taxable entity as that which sustained the loss and reliance was placed on the interpretation of the term 'the taxpayer" as it is used in section 122(b)(2), Internal Revenue Code of 1939. The Commissioner makes use of some of the language of the Supreme Court in *Libson Shops* in his argument here, but we think the language is not controlling, first because the fact situations in *Libson* and the case before us are dissimilar and second, and more strongly, because the Court in footnote 9 to *Libson* said:
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> > "We do not pass on situations like those presented in Northway Securities Co. v. Commissioner, 23 B.T.A. 532; Alprosa Watch Corp. v. Commissioner 11 T.C. 240; A. B. & Container Corp. v. Commissioner, 14 T.C. 842; WAGE, Inc., v. Commissioner, 19 T.C. 249. In these cases, a *single* corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credits of another.'
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> "The case before us involves the same kind of situation as that described in the footnote referred

to above. Here we have a single corporate taxpayer which changed the character of its business and claims the right to reduce the taxable income of one of its enterprises, the automobile business, by the losses of another, the appliance business. The cases cited in the footnote have held that this could be done, and so far as we can see, the Supreme Court has not held otherwise in *Libson*."

The decision of the Tax Court was reviewed by the entire Court (5 judges dissenting). It may be anticipated, therefore, that the Tax Court will adhere to that position regardless of the position taken by the Court below and regardless of the position taken by the Court of Appeals for the Ninth Circuit, until the question is determined by this Court.

We submit that this Court should grant certiorari in order that the conflict on this important question be finally determined.

The preceding paragraphs have been predicated on the assumption that, in basing its decision in part on *Libson Shops* v. *Koehler*, the Court below construed that decision as governing Section 172 of the 1954 Code. This assumption seems warranted, in view of the fact that the taxable year involved in this case commenced September 1, 1954, and ended August 31, 1955, a period governed by the provisions of the 1954 Code. See Section 7851(a)(1)(A) of the 1954 Code. The various references in the opinion of the Court below to provisions of the 1939 Code, however, and the apparent refusal of the Court to agree with the petitioner that the 1954 Code is applicable, may suggest that the decision below is predicated upon a belief that the provisions of the 1939 Code, and not those of the 1954 Code, govern this case. If such was the view

of the Court below, its basis was probably the fact that the net operating losses sought to be deducted in a year governed by the 1954 Code were incurred in years during which the 1939 Code was applicable. However, Section 172 of the 1954 Code specifically states that reference shall be made to the 1939 Code only to determine the computation of the net operating loss and the number of years that it may be carried forward, questions not in dispute in this case. If the Court below based its decision on the 1939 Code, we submit that the decision below is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

In the light of the clear error of applying the provisions of the 1939 Code to this case, we believe it is more reasonable to assume that the Court below held that the 1954 Code governed this case, but that Section 172 of the 1954 Code must be construed in the light of *Libson Shops* v. *Koehler*. Thus, we construe the holding of the Court below to be that *Libson Shops* v. *Koehler* is applicable under the 1954 Code. We believe that such a holding conflicts with other provisions of the 1954 Code and should not be permitted to stand. For example, the precise holding in *Libson Shops* v. *Koehler*, decided under provisions of the 1939 Code, is in conflict with Sections 381 and 382(b) of the 1954 Code, in that these sections appear to provide generally that, if certain stock ownership tests are met, a corporation surviving a merger will be able to use the entire loss carryforward of the other corporations parties to the merger, even though the effect thereof will be to permit losses from one type of business to be offset against profits from another type of business. See Sen. Rep. No. 1622, p. 52, 83d Cong., 2d Sess.

If it be assumed that *Libson Shops* applies to the single continuing corporation, a ruling under the 1954 Code that a single continuing corporation loses its net operating loss carryforward upon a change of business conflicts with the provisions of Section 382(a) of the 1954 Code. That subsection provides that a single continuing corporation may lose its loss carryforwards if there is both a change of business and a substantial change in stock ownership, the inference being that a change of business of itself will not affect the corporation's net operating loss carryforwards.

The ruling of the Court of Appeals that *Libson Shops* is applicable in construing the provisions of the 1954 Code seems to be based upon a misconception as to the real significance of that decision. *Libson Shops*, which was expressly based on provisions of the 1939 Code, hinges on the meaning of the term "taxpayer" that appeared in Section 122 of the 1939 Code. That term does not appear in the relevant portions of Section 172 of the 1954 Code. Furthermore, this Court decided *Libson Shops*, as we understand that decision, in order to clarify certain conflicts that had arisen under the 1939 Code with respect to the effect of mergers and other reorganizations on the loss carryovers of constituent and surviving corporations. See Sen. Rep. No. 1622, p. 52, *supra*. In the light of Sections 381 and 382 of the 1954 Code, however, those conflicts do not exist under present law. It seems clear that a rule to the effect that *Libson Shops* governs Section 172 of the 1954 Code—the apparent rule of the Court below—will result in defeating the clear provisions of the 1954 Code relating to the effect on carryforwards of mergers and other reorganizations. Sections 381 and 382.

We submit that the question whether *Libson Shops* is to be followed under the 1954 Code is an important question that should be considered by this Court.

**Section 269 of the 1954 Code**

This case involves, in the second instance, the proper construction of Section 269(a) of the 1954 Code. The District Court in holding that Section 129(a) of the 1939 Code [now Section 269(a) of the 1954 Code] was not applicable to this case said:

> "In the first place, the acquisition by the present stockholders of the control of the plaintiff corporation did not serve to secure to the present stockholders any deduction credit or other allowance which such person, meaning the new stockholders or any one of them, or the corporation, would not otherwise enjoy. The plaintiff, which is the Mill Ridge Coal Company, before the sale of its stock was entitled to the benefit of a net operating loss carryover. Therefore the acquisition of the control of the plaintiff by the present stockholder did not result in securing to the plaintiff, the corporation, the net operating loss carryover because it already had it. The present stockholders did not secure any deduction credit or other allowance through their acquisition of the stock from the DeBardelebens because they, as individuals and for the purpose of applying this section there is a distinct difference between the corporate entity and the stockholders, they themselves are not entitled, they are not claiming as individual stockholders the benefit of a net operating loss carryover."

The Court of Appeals reversed the District Court in this respect, although its reasons for doing so are not clear. The ruling of the Court below conflicts squarely with the considered opinions of the Tax Court

in many decisions, the most recent of which is *British Motor Car Distributors, Inc., supra.* In that decision the Tax Court stated:

> "While it is true that section 129 did not control the situation in *Alprosa Watch Corporation,* 11 T.C. 240 the Commissioner nevertheless made the 'suggestion' that the legal principles set forth in that section 'may well have been the law existing prior' to its enactment. In disposing of this argument the Court said:
>
> > 'There is considerable doubt in our minds that, even assuming that this case were to be governed by section 129, the facts constitute a situation condemned by that section. That section would seem to prohibit the use of a deduction, credit, or allowance only by the *acquiring person or corporation* and not their use by the corporation whose control was acquired. [Emphasis supplied.]
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> "While the Court's language in *Alprosa Watch* has been characterized as dictum by some (see Tarleau, Acquisition of Loss Companies, Taxes, Vol. 31, 1050, 1054), we have given effect to it, inferentially, at least, in *A. B. & Container Corporation,* 14 T.C. 842; *WAGE, Inc.,* 19 T.C. 249; and *T. V. D. Co.,* 27 T.C. 879, 886. In the latter case, we said, 'It is manifest from the unambiguous terms of section 129 that it applies only to an acquiring corporation.' In the situation before us we have British Motor Car Distributors, Ltd. as petitioner. In effect, petitioner is the acquired corporation, its stock having been acquired by the partnership. It is petitioner, though its majority stock was acquired by the partnership, which is here seeking to make use of its previous losses. While its new stockholders may gain some tax advantage as stockholders because of petitioner's use of its losses, it is still the petitioner and not the stockholders who seek to claim the benefit in

the case before us. *We think the possible benefit which may flow to the new stockholders is too tenuous a benefit to bring section 129 into play.* The fact that petitioner originally bore a different name which was changed as part of the transaction in which the stock changed hands does not alter the situation. *Alprosa Watch Corporation*, supra, *A. B. & Container Corporation, supra.* Nor does the fact that there has been a change in the business of the petitioner after the acquisition call for a change in the result. Such a change occurred in both the *Alprosa* and *A. B. & Container* cases." (Italics added.)

We submit that Section 269 of the 1954 Code may be applied to this case only if the corporate entity of the petitioner, an active corporation doing business with persons other than its stockholders, can be disregarded, for only in this manner can the present stockholders of the petitioner be said to have secured a "benefit" that springs from petitioner's net operating loss deduction—a deduction that can be claimed only by the petitioner and not by its stockholders. The crux of the Government's argument, both in brief and at oral argument in the Court below, was that the taxpayer's new stockholders obtained a benefit which they would not otherwise enjoy. The benefit interdicted by Section 269 of the 1954 Code is the direct use of a deduction by the acquiring person, and this did not occur in this case. If it be assumed that the corporate entity may be pierced for purposes of Section 269, we submit that a piercing of the corporate veil in this case—involving an active going corporation doing business with persons other than its stockholders—would conflict with long standing decisions of this Court. *National Carbide Corp.* v. *Commissioner*, 336 U. S. 342 (1949); *Dalton* v. *Bowers*, 278 U. S. 404

(1932); *Burnett* v. *Commonwealth Improvement Co.*, 307 U. S. 14 (1932). Moreover, here the Government has collected the taxes in question from the taxpayer corporation and thus has recognized the corporation as the taxable entity in this case. *Mead Corp.* v. *Commissioner*, 116 F. 2d 187 (3rd Cir., 1940); *A. B. & Container Corp., supra.*

The Government has claimed erroneously that the business purpose requirement of *Gregory* v. *Helvering*, 293 U. S. 465 (1935) was not met in this case. The rule of the *Gregory* case was clearly met in this case because the taxpayer corporation is not a sham corporation, as was the case in *Gregory*. The taxpayer corporation in this case is a separate corporate taxpayer actively conducting a business enterprise entirely apart from its stockholders, and is conducting that business for valid business purposes. Accordingly, the *Gregory* case is not applicable. For the same reason the doctrine of *Higgins* v. *Smith*, 308 U. S. 473 (1939) is not applicable to this case.

## CONCLUSION

The decision of the Court of Appeals deals erroneously and ambiguously with matters of importance. We respectfully request that the writ of certiorari be issued.

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